

Residential Real Estate Closings – Beyond the Basics

Tim Gartin

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I. Preliminaries -- a few ethics reminders.

In a closing where there is a lender, the lender is the client. The attorney is bound by ethical standards where other parties may not be so bound.

A. Communications with the lender.

1. The attorney must inform the lender of any information that is adverse to the lender or that the lender needs in order to make decisions about the closing.¹ The attorney is not permitted to “look the other way” to make things convenient for a borrower.²

Practice pointer. You must inform the lender of material changes in the borrower’s circumstances if you become aware of them. Examples would include learning that a borrower has changed jobs without the lender’s knowledge, or that the borrowers intend to use a property as a rental property rather than live there. Ask the borrower to confirm the information on the loan application.

Practice pointer. To reinforce what is perhaps obvious: the attorney must communicate with honesty to the lender. For example, where loan documents are to be executed on a particular day in keeping with an interest rate lock, the attorney must not allow misrepresentation about the date the documents are signed. Another example would be predated three-day right of rescission forms.

B. The attorney has a duty of competence.³

1. You have a duty to associate with other attorneys if you need assistance.⁴ If you do not know how to handle a particular problem in a closing, call another attorney.

¹ I.C.A. Rule 32:1.4 (2005).

² Id. cmt. 7. “A lawyer may not withhold information to serve the lawyer’s own interest or convenience or the interests or convenience of another person.”

³ I.C.A. Rule 32:1.1 (2005).

⁴ Id. cmt. 1.

2. Take advantage of opportunities to keep up on changes in real estate law by being a member of the Real Estate Section of the Iowa Bar Association. Another resource is www.dirt.umkc.com.

II. Before the closing.

The closing is *not the time* to work out unresolved issues.

A. Understand the structure of the intended closing.

1. There is a lot of information that you should have in your file when setting up a closing. See Exhibit A for a sample worksheet. Many problems arise by not knowing who is doing what in a closing.

2. Contact the sellers if unrepresented by a realtor or attorney and let them know what you will expect of them and what they can expect of you. See Exhibit B for instructions to give unrepresented sellers. Find out if they need their funds for a simultaneous closing.

3. Obtain and review the purchase agreement and any amendments. A lender must be provided any amendments to the purchase agreement.

4. Be aware that a conveyance of property where there is a homeowners' association sometimes requires the association's waiver of a first right of refusal. See Exhibit C for a sample form.

5. Review the closing instructions from the lender carefully. Make sure you are capable of following all of the instructions (*e.g.*, the timeframe for providing the title policy, whether a power of attorney is permitted, what the lender requires in order to send the funds).

B. Who is the buyer? Who is the mortgagor?

1. Immediate transfers. Many lenders do not loan money to a trustee or business entity that owns (or will own) the real estate. Hopefully this will change over time, especially as people increasingly use trusts in their estate planning and limited liability companies and corporations for owning income property. However, in the mean time, lenders may ask for the real estate to be conveyed from the trustee or entity to the

individual (often the settlor or owner of the entity), before giving the new mortgage, and then re-convey the real estate to the trustee or entity. There are risks to this on two levels:

a. Borrowers should be advised that the return conveyance will violate the terms of the due-on-sale clause in the mortgage, and therefore they should obtain written permission from the mortgagee to make the transfer back to the trustee or entity.

b. Even more serious, one has to be cautious about structuring the transaction to accomplish what could not otherwise be done. The lender may not be informed about what the loan originator is doing. If the loan originator or closing department will not provide written approval for the immediate transfer back, this should be a warning sign of a fraudulent transaction. *The "Don't ask, don't tell" policy does not apply to the closing agent.*

2. Getting the right mortgagors. Lenders often do not understand who must join in giving a mortgage in the following situations:

a. When there is a non-borrower spouse (regardless of whether said spouse is a titleholder);

b. When the titleholder's parents are also borrowers and are either titleholders or not titleholders.

This can lead to not having needed people at the closing and potentially having defective mortgages. *All titleholders and their spouses must join in giving a mortgage, regardless of whether they are borrowers. Borrowers who are not titleholders do not have a mortgage interest to give.*

C. Review the title opinion to verify what is needed in order pass clear title.

1. Make sure that the attorney who prepared the preliminary title opinion is a member of Title Guaranty so that a Title Guaranty policy can be obtained.

2. If you do not do the title opinion, be clear about what the examining attorney needs to address title objections.

3. When you do examine the abstract and find objections, take extra measures to bring unusual objections to the attention of the lender and realtors, such as a note on the fax cover sheet or e-mail.

4. Be careful to note whether a mortgage is securing a line of credit. *Open-ended mortgages require written instructions to close the line of credit in order to obtain a mortgage release even if the outstanding balance has been satisfied.* If the payoff statement does not show it is a line of credit, the closing agent may not realize that a line of credit is involved and not obtain the necessary written instruction from the borrower to close the line of credit. Unless closed, the borrower may continue to use the line of credit – even after conveying the real estate. Remember that such a mortgage cannot be forced off the title by Title Guaranty.

D. Construction within 90 days of closing.

1. Mechanic's liens. For closings where there has been construction within the prior 90 days, obtain either (1) a statement from the general contractor listing the subcontractors involved, the amount owed to the subcontractors, and lien waivers from all parties providing labor or materials, or (2) an indemnification agreement that the sellers (or owners in the case of a refinance) indemnify the lender in the event liens are filed which would interfere with the priority of the new mortgage.

2. Unfinished items. If there are unfinished items by the time of the closing (whether due to construction or surprises at the walk through) and the parties still want to close, the parties can use an escrow agreement. See Exhibit D for a form for establishing an escrow account. This approach is risky where the amount of the repairs cannot be determined with certainty (e.g., replacing a toilet compared to dealing with an unknown sewer line blockage).

E. Relocation companies.

1. Determine the timeframes for HUD approval.
2. The relocation company cannot be named as the seller on the HUD unless taking title.⁵ At most, you can recite that the relocation company is the agent for the seller.

F. The disposition of U.S. real property interest by a foreign person.

1. An overview of the Foreign Investment in Real Property Tax of 1980 (FIRPTA).⁶
 - a. When handling a closing where the seller is a foreign person, you must determine whether FIRPTA will require action.
 - b. The interest in real property could be either ownership of the real estate or direct ownership of an interest in a business entity that is considered a real property holding entity.
 - c. The settlement agent and the buyer are responsible to ensure that ten percent of the gross purchase price is withheld and sent to the IRS using Form 8288 and Form 8288-A. The settlement agent could be held responsible if the money is not sent.
2. Threshold for the tax.
 - a. When the purchase price is less than \$300,000 and the buyer purchases the real estate for a home and lives there for a prescribed amount of time.
 - b. Note that a foreign seller may request a reduction or elimination of the withholding from the IRS.⁷

⁵ See 12 USCA, RESPA Reg. X, 24 C.F.R. Pt. 3500 App. A, Instructions for Completing HUD-1 and HUD-1A Settlement Statements (2006) (requiring that the actual seller be recited on the settlement statement).

⁶ See I.R.S. Publication 515. Withholding of Tax on Nonresident Aliens and Foreign Entities, available on www.irs.gov (using “FIRPTA” as a key search word).

⁷ Id.

G. Preparation of the HUD governed by federal regulations and state law.

1. Federal regulations. The rules generated by the Department of Housing and Urban Development are a good resource for the settlement agent to have close at hand.⁸

2. State law. Iowa Code § 535.8 (2005) provides the statutory framework for allowable fees which can be shown on a settlement statement.⁹

H. The legal description.

1. Confirm consistency of the legal description used on title opinion, deed, and mortgage.

Practice pointer. Especially with a new construction, make sure that the street address and legal match.

2. Simplify the legal description wherever possible to reduce the risk of scrivener errors.

1. Power of attorney approval. Obtain approval of the power of attorney well in advance. In the last several years, lenders have started requiring additional information to be shown on the power of attorney such as the loan number, loan amount, and street address.

J. The U.S. Patriot Act.

A rule that has not received much attention is Executive Order No. 13224 on terrorist financing. This Order requires closing agents to verify whether the sellers' or buyers' names are on the Specially Designated Nationals and Blocked Persons List. This list is found at www.ustreas.gov/offices/enforcement/ofac/sdn. You should review this site to determine whether you should include this step in your closing procedure. It may

⁸ See 12 USCA, RESPA Reg. X, 24 C.F.R. Pt. 3500 App. A, Instructions for Completing HUD-1 and HUD-1A Settlement Statements (2006) (requiring that the actual seller be recited on the settlement statement).

⁹ See Gardin v. Long Beach Mortgage, 661 N.W.2d 193 (Iowa 1993) (discussing the showing of fees on a settlement statement).

be that in the future abstracters will make this part of their search process. Software may be available soon to assist with this search. At the very least, the parties to a real estate transaction should provide a driver's license or passport to verify their identity.

III. At the closing table.

A. Be on guard for fraud.

1. Confirm the identification of the borrowers.
2. Ask the borrowers to verify that the information provided on the loan application is true and accurate.
3. No side agreements (*e.g.*, unauthorized seller carry back or additional loan origination fees). See Exhibits E and F for letters describing an actual fraudulent situation involving loan origination fees not shown on the settlement statement.
4. Familiarize yourself with fraud techniques. See www.mortgagefraudblog.com. This is a fascinating website which reports on mortgage fraud cases around the country.

B. The form of funds. It is imperative that the parties understand that the availability of funds you have to disburse depends on the form of the funds coming into your trust account. Talk with the bank that handles your trust account to understand the rules pertaining to the length of time required to disburse money received in various forms. If this is not followed, you will end up improperly borrowing other money held in your trust account for other purposes or you will overdraw your trust account.

C. No changes to the documents. Executed documents cannot be modified without the approval of the person(s) executing the document.¹⁰

¹⁰ McNertney v. Kahler, 710 N.W.2d 209 (Iowa 2006) (holding that adding a name to the deed after the deed rendered the deed a nullity because delivery of the deed meant that the grantor no longer had an interest to convey to the proposed grantee).

Exhibit A

Closing Set-Up Worksheet

_____ to _____
Projected Closing Date _____

Today's date:

Lender

Name:

Contact person:

Phone:

Fax:

e-mail:

Purchase / Refinance

Sellers (if a purchase)

Name:

Contact info (if fsbo)

Phone:

Fax:

Forwarding address:

Realtor (if applicable):

Attorney (if applicable):

Who will obtain payoff(s):

Buyers / Borrowers

Name:

Contact info (if fsbo)

Phone:

Fax:

e-mail:

Other parties

Escrow company:

Contact info (if fsbo)

Phone:

Fax:

e-mail:

Relocation company:

Contact info (if fsbo)

Phone:

Fax:

e-mail:

Special Instructions

2nd loan?

Location of earnest money:

Closing Instructions

Anticipated date for receipt of closing instructions:

Authorization process: Table funded or approval required

Special instructions:

Exhibit B



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GEORGE H. CLARK (1895-1974)
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Instructions to a Party Selling Real Estate without an Agent or Attorney

The following documents need to be provided to me as the closing attorney no later than 48 hours in advance of the closing:

- 1) Warranty deed (should be prepared by an attorney).
- 2) Declaration of Value (available from the County Recorder's office).
- 3) Groundwater Hazard Statement (avail. from the County Recorder).
- 4) Power of Attorney (if one is used, it should be prepared by an attorney).
- 5) Title Guaranty Composite Mortgage Affidavit (can be obtained from an attorney).
- 6) Payoff statement from each mortgage holder. The payoff needs to include the interest per diem.
- 7) Invoices for any bills you would like to have paid out of your proceeds (assuming there are proceeds). *E.g.*, abstracting, attorney fees.
- 8) Instructions with what to do with your proceeds. The proceeds can be mailed, picked up, or wire transferred to your account. If you would like us to wire the money, we will need wiring instructions from your lender.
- 9) Instructions on how to provide you with a draft of the settlement statement to review (preferably by fax). You will need to sign this.
- 10) You are responsible for addressing any title problems that are presented in the preliminary title opinion. I suggest that you ask the broker if there are such issues. Examples of such problems include unpaid judgments, liens, child support, alimony, court costs, estate matters, unpaid taxes, and boundary matters.

- 11) You do not need to obtain the real estate tax proration. We will prepare this.

I also recommend that you consider the following:

- 1) Make sure all arrangements for the transfer of keys, garage door openers, etc. are resolved well in advance of the closing.
- 2) Allow enough time between the final walk-through inspection and the closing to resolve any matters that come up during the walk through.
- 3) **Obtain legal counsel to review your rights and obligations as the seller and to assist you with document preparation.**

Please call me if you have any questions.

Exhibit C

Space above for recording data

By: Attorney's Name, Att'y at Law, Attorney's address and phone number

AFFIDAVIT: WAIVER OF RIGHT OF FIRST REFUSAL

WHEREAS, the Declaration of Submission to Horizontal Property Regime for <> (hereinafter "**Declaration**") dated <>, was filed of record <>, as Inst. No. _____ of the <> County Recorder's Office.

WHEREAS, paragraph <> of said Declaration grants an option to exercise a right of first refusal to <> (the "**Association**") as more particularly set forth therein; and

WHEREAS, the following legally described unit is to be sold, given as a gift, devised, leased or otherwise transferred from the Unit Owner:

<>

NOW, THEREFORE, the Association hereby expressly waives, relinquishes and releases any and all option rights in and to the real estate described above set forth in Paragraph <> of the Declaration with respect to this specific ownership transfer; the transferring Unit Owner for the transfer is listed as: _____

<name of association>

by _____
Print name and office: Date

Subscribed and sworn or affirmed before me by <> as <office> of <name of association>, this _____ day of _____, 20__.

Print name here: _____
Notary Public in and for said State and County

Exhibit D

Escrow Agreement

Postponed or Uncompleted Improvements or Repairs

Seller(s):
Buyer(s):
Builder(s):
Escrow Agent:

Property Address:
Legal Description:

To allow for transfer of title and possession of the above-described property, [and to allow _____ to close a mortgage loan on the property] prior to completion of the improvements or repairs described herein, the undersigned agree as follows:

1. The following items remain to be completed by the _____ hereinafter referred to as "Responsible Party" and shall be known as the "work":

	To be completed	Estimated Cost
A.	_____	\$ _____
B.	_____	\$ _____
C.	_____	\$ _____
D.	_____	\$ _____

2. The purpose of this Escrow Agreement is [to allow _____ to close Buyer's mortgage loan prior to completion of the above-described work and] to insure the prompt completion of said work.

3. The Responsible Party agrees to complete the above work no later than _____. If the work is not completed by this date, the Escrow Agent may employ any third party satisfactory to it for the purpose of completing any or all of the above items of work. In order to secure the Responsible Party's performance and the completion of the above items in a timely and satisfactory manner, Escrow Agent or its agent shall hold in escrow 150% of the estimated cost of completion, or \$ _____ of the Responsible Party's proceeds in a non-interest bearing account. The Escrow Agent may use any portion or all of the funds held in escrow for the purpose of paying any third party employed by Escrow Agent in accordance with the terms of this paragraph.

4. The Responsible party shall be personally liable for the satisfactory completion of the work, including waiver or discharge of any mechanic's lien in connection therewith.

5. When the work is completed, Responsible Party shall notify Agent and Buyer. The items of work shall then be inspected to determine whether all of the work required herein has been satisfactorily completed. Escrow Agent shall assign the inspection to an appraiser of its choice duly licensed as such the State of Iowa. If the appraiser approves of all the work to be performed hereunder, the Escrow Agent shall release the balance of the funds held in escrow, if any, to the Responsible Party. The appraiser's decision as to the satisfactory completion of the work will be final. The Responsible Party will provide satisfactory evidence to assure that no mechanic's liens are outstanding or can attach on account of the work. Should the Responsible Party wish, the Escrow Agent will pay direction to a contractor the sum required to reimburse said contractor for the work done to the property.

6. The Responsible Party and the Buyer agree to hold the Escrow Agent and its agent harmless from any liability with respect to performance of its duties as escrow agent, the Escrow Agent's decision with respect to any release of the escrow funds, and the employment of any third party.

7. Escrow Agent shall have a prior lien on the funds deposited herewith for any costs, including inspections, fees, court costs, and reasonable attorney fees, which it may incur during the course of administration of this agreement, or as a consequence of becoming a party to any legal or equitable proceeding which is brought by any third party claiming an interest in the escrowed funds or by any party which disputes the manner of the disposition of the funds.

8. If the Responsible Party is a Seller or a Builder, and agrees to contract with the buyer to do the work, an agreement must be signed at closing between the Seller or Builder and the Buyer which must contain a specific amount which the Buyer is to receive for completing the work. The Escrow Agent must be provided a copy of any such agreement.

9. If the Responsible Party is the Buyer, the Escrow Agent shall have the right to do any act allowable by this Agreement to perfect its mortgage lien, including, but not limited to, completing the work in the event Buyer fails to do so.

Dated this _____ day of _____, 200__.

Buyer(s)

Seller(s)

Escrow Agent

◇

By _____

Exhibit E



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◇

Lender's name
Address

Attn: ◇

RE: Borrower: John Doe
Loan #: ◇
Property: ◇
Closing Date: ◇

Dear ◇:

I am the attorney who closed the above-referenced transaction and am writing to inform you of what I believe to be a fraudulent transaction associated with this loan. We spoke on the phone about this on ◇.

At the end of the closing, Fred Jones [not his real name] (the mortgage broker) told Mr. Doe that he could pay for the origination fee (between \$1200 and \$1500) by personal check. I was perplexed by this and asked Mr. Jones to explain why an origination fee would be paid outside of the closing. He explained to me that your company would not allow the fee to be shown on the closing statement and so it was going to be handled outside the closing. I told Mr. Jones and Mr. Doe that I was not comfortable with this and that I wanted to contact Mr. Jones' supervisor for clarification.

Mr. Jones and I then went into another room and called Bob (I believe his last name may be ◇) and I asked Bob to explain the presence of an origination fee outside of the closing. He said, "Tim you have got to understand that this is a gentlemen's agreement." Bob told me that he has been in the mortgage business for over 10 years. I told him that I would not permit him to deviate from the parameters of the loan that you provided me. After going back and forth about the permissibility of handling the fee outside of the

closing, Bob finally agreed to forego the fee. This ended the conversation.

Mr. Jones and I then returned to Mr. Doe. I explained to Mr. Doe that the origination fee could not be collected and that it should not be paid. However, Mr. Doe had already given Mr. Jones the check. I saw Mr. Jones return the check to Mr. Doe. The parties then left. I haven't talked with Mr. Doe further to see if there was a subsequent attempt to collect the fee.

At this point, I am putting this matter in your hands to investigate further. Although this appears to be a clear violation of the HUD regulations, I don't know how to move forward. Please have your corporate counsel call me as soon as convenient.

Very truly yours,
Hastings & Gartin, LLP

by

Timothy L. Gartin

TLG:mac

Exhibit F



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◇

Lender's name
Address

Attn: ◇

RE: Borrower: John Doe
Loan #: ◇
Property: ◇
Closing Date: ◇

Dear ◇:

I am writing to supplement the letter I sent you on October 4, 2005 regarding the above transaction. Again, I served as the settlement agent in this matter. When Mr. Jones and Mr. Doe left my office, Mr. Jones had returned the check at issue to Mr. Doe. I witnessed this. I had explained to both of them that this fee was not one that was allowed in the transaction pursuant to your requirements. There was no ambiguity about this. However, I have been curious as to whether there was an effort after the closing to collect this money from Mr. Doe.

Today, I spoke by telephone with Mr. Doe. I asked him whether he had been asked for the money at issue after leaving my office. He was reluctant to answer initially, but soon explained that he did in fact give a check to Mr. Jones in the amount of \$900 (not the \$1200 to \$1500 amount that I originally thought). This represented a 1% loan origination fee on the \$90,000 borrowed. Mr. Doe stressed to me that Mr. Jones did not ask for the money, but that he wanted to give him the money.

I then immediately called Mr. Jones and asked him if had attempted to collect the origination fee after the closing. He denied it. I asked him if he was sure. He said he

was positive. I asked him why Mr. Doe had just told me that he (i.e., Mr. Doe) gave him \$900. Mr. Jones repeatedly responded: "There was no check given to <Name of mortgage brokerage>." I asked him whether he believed that Mr. Doe was confused or not telling the truth since I had just talked to him moments ago. He said he didn't know. I sensed that Mr. Jones was not being forthright with me and asked him more broadly whether there was any transfer of money from Mr. Doe to himself after leaving the closing. After several more minutes of denial, Mr. Jones finally conceded that he had in fact accepted a check for \$900 that was made out to him personally. He denied that <Name of mortgage brokerage> knew about the payment.

I then attempted to understand how Mr. Jones could have accepted this money given the fact that I made it very clear that it was not allowed. This is a very troubling point to me because Mr. Jones claimed on the day of the closing that he did not know that it was improper for him to accept the origination fee outside of the closing. He said that Mr. Doe voluntarily gave him the money as a friend. I asked him whether Mr. Doe would otherwise have given him the money if it would not have been for his assistance with the loan. He acknowledged he would not.

I explained to Mr. Jones that from my perspective, he had no right to receive those funds and that he should immediately return the money to Mr. Doe. He did not confirm what he would do. I also told him that he should seek legal counsel. After ending the telephone call with Mr. Jones, I called you immediately to inform you of this update.

I am very concerned about this transaction. It appears to me that <Name of mortgage brokerage> (and perhaps Mr. Jones) individually have attempted to defraud you in the way in which this loan was handled. They were contractually bound to follow the parameters you set for this loan and then intentionally violated the terms. I encourage you to audit this file completely to determine whether there was further fraud in terms of representations made to you regarding Mr. Doe's economic status. I also need direction as to what I should do next. I recommend reporting this matter to the board that gives oversight to lending in Iowa and contacting the FBI to see if they believe that federal laws have been violated. Perhaps a complaint should be filed with our police department. Please forward my correspondence to your corporate counsel at your earliest convenience. Thank you for taking the time to talk to me this morning.

Very truly yours,
Hastings & Gartin, LLP

by

Timothy L. Gartin

TLG:mac